DRN-5228958

The complaint

Mr and Mrs C are unhappy with how Aviva Equity Release UK Limited has allocated some voluntary partial repayments ("VPR") they've made to their lifetime mortgage.

What happened

Mr and Mrs C took out this lifetime mortgage in December 2017 through a mortgage broker. They borrowed £185,000 at an interest rate fixed at 3.92%. For ease of reference, I will call this sub-account 1.

As part of the agreement Mr and Mrs C had an additional cash reserve of £205,000 which they could draw down at a later time (either in one go or in tranches) and the interest rate charged for that would be whatever the prevailing rate was at the time the additional funds were drawn down. The following draw downs were made from that cash reserve:

Date of draw down	Amount of draw down	Interest rate	I will refer to this as
January 2019	£50,000	4.90%	Sub-account 2
January 2020	£50,000	3.79%	Sub-account 3
February 2021	£25,000	3.61%	Sub-account 4
August 2021	£25,000	2.97%	Sub-account 5
March 2022	£25,000	3.71%	Sub-account 6
August 2022	£20,000	4.52%	Sub-account 7

In each case, the applicable interest rate is fixed for the lifetime of the mortgage.

An early repayment charge ("ERC") would be incurred if any of the sub-accounts were repaid either in full or in part (outside of the VPR allowance), with the ERC end dates running from March 2036 up until December 2040.

The original mortgage offer set out that overpayments – VPRs - could be made to the account, with that section of the mortgage offer stating:

> **‘Overpayments**
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> Once you have had your lifetime mortgage for one year, you can choose to make partial repayments.
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> Each year, the maximum amount you can repay is 10% of the initial amount you have borrowed. If you borrow more or borrow from your cash reserve you can also repay up to 10% of those amounts each year. You can repay in up to 4 instalments every year but each must be a minimum of £500.
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> When you make a partial repayment we will apply this to your lifetime mortgage on the day the money is received and the amount on which we charge interest will reduce. We will send you a statement to show how your lifetime mortgage has reduced.
>
> This is more fully explained in your terms and conditions booklet.’

The terms and conditions booklet said:

- ‘Your Lifetime Mortgage is a special type of loan designed to run for the rest of your life. You will not make any monthly repayments during the Term of your Lifetime Mortgage, although you will have the option to make occasional voluntary partial repayments in accordance with Section 5 if you wish to do so.’
- ‘We will always act fairly, in good faith and in a reasonable manner towards you when we deal with your Lifetime Mortgage and when we apply or enforce these Conditions. We encourage you to tell us whenever you feel we have not done so. This promise is an overriding principle and you should read each of the Sections in these Conditions in light of this promise.’

And in Section 5 specifically:

5.8 After 12 months has elapsed since the Completion Date of your Lifetime Mortgage you may make up to 4 voluntary partial repayments in any subsequent 12 month period preceding an Anniversary Date provided that:

   a. the minimum amount of any single payment is £500;

   b. the maximum aggregate payment that you make in any such 12 month period is 10% of the sum of the initial loan amount, any Additional Borrowing and Cash Payments (and not, for the avoidance of doubt, taking into account any interest accrued, mandatory or voluntary partial repayments made or the Cash Reserve), although Aviva reserves the right to vary the maximum payment at any time by giving notice to you;

   c. in the previous 12 months you have neither taken any Cash Payments from your Cash Reserve under Section 2 nor been given any Additional Borrowing under Section 13;

   d. Aviva is informed in advance of the voluntary partial repayment; and

   e. the voluntary partial repayment is made by BACS, CHAPS, Faster Payments, Debit Card or cheque.

   Aviva reserves the right to return any voluntary partial repayment in full where any of the above conditions are not satisfied.

5.9 Voluntary partial repayments will not be applied until cleared funds are received and will be used to reduce the Total Amount You Owe. A repayment statement will be issued to confirm the voluntary partial repayment.

5.10 Aviva will explain to you how any voluntary partial repayment amount will be applied in advance of a voluntary partial repayment being made and will, upon your request, also provide this explanation in writing at that time.

In December 2019 Aviva wrote to Mr and Mrs C to say it had made some improvements to the terms of their lifetime mortgage. It said:

- ‘You can now make as many repayments per year as you like, up to a total of 10% of the total amount you borrowed
- Each repayment can be a minimum of £50
- Further borrowing isn’t restricted after a repayment
- You can make a repayment as soon as one day after taking the initial loan, additional borrowing or a reserve release’

The letter said that if Mr and Mrs C were interested in making a VPR then they should get in touch with Aviva and it would give them all the details they need about how to make the payment and anything else they need.

Mrs C phoned Aviva on 6 December 2022 to discuss making a VPR. A complaint was raised over the phone that day as Mr and Mrs C weren’t happy that the most recent draw down would be repaid first, rather than the one at the highest interest rate (which is what they wanted to do).

On 12 December 2022 Mr and Mrs C made a £38,000 payment, which fully repaid sub-account 7 and reduced the outstanding balance on sub-account 6.

And then on 29 December 2022 they made a further £38,000 payment which repaid the remaining balance on sub-account 6, fully repaid sub-account 5 and reduced the outstanding balance on sub-account 4.

In the meantime, Aviva started to look into the complaint that Mr and Mrs C raised in the phone call of 6 December 2022, and they had expanded on in an email to Aviva on 14 December 2022.

Aviva responded to the complaint on 13 February 2023. It said, in summary:

- Its terms don’t say that a customer can dictate how it applies VPRs, only that it is required to explain how the VPR will be applied.
- Mr and Mrs C had proceeded with making the VPRs after being provided with the explanation of how they will be applied.
- It had relaxed some of the rules about VPRs in 2019 – with those changes not negatively impacting customers – which was allowed.
- It applies each VPR to the most recent tranche of borrowing first. By doing that entire tranches can be paid off, which is what had happened in Mr and Mrs C’s case.
- Early repayment charges would be incurred for overpayments or full redemptions outside of the VPR process.
- The product is flexible as it allows for draw downs and VPRs.

- It is regulated by the Financial Conduct Authority and it wouldn't be allowed to offer products with unfair terms. Mr and Mrs C received independent financial and legal advice before taking out the lifetime mortgage, and if they feel the product no longer suits their needs then they should seek further independent financial advice.

Mr and Mrs C referred the complaint to the Financial Ombudsman Service where it was looked at by one of our Investigators. Our Investigator didn't uphold the complaint as he felt Aviva had applied the terms of the agreement fairly, and that it had informed Mr and Mrs C correctly about its current policy for managing VPRs.

Mr and Mrs C didn't agree and so the case was passed to me to decide. They said, in summary:

- If Aviva's policy is that the most recent draw down – rather than the most expensive – should be repaid first then that should be clearly stated in the terms and conditions so there is no ambiguity.
- Aviva explained how the VPR would be allocated in the call of 6 December 2022, but that is too late as it should have been set out in the terms and conditions.
- There are serious financial costs involved as they repaid a draw down that was being charged at 2.97% but had been left with a draw down being charged at 4.90%.

What I've decided – and why

I issued a provisional decision earlier this month, the findings of which said:

> 'While grammatically easy to follow, the relevant terms setting out the VPR process is very broad – saying that Aviva will explain how any VPR will be applied in advance of it being made - providing seemingly unfettered discretion about how Aviva can allocate VPRs to the lifetime mortgage account and with no opportunity for the borrower to express a preference. The contract allows for further borrowing, at the then prevailing interest rate – which is different to the starting rate. I think that, as a result, decisions over which part of the borrowing to apply a VPR to could have real consequences for the overall cost of the mortgage to the customer – but the agreement does not allow a customer to understand what the implications of that might be.
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> In those circumstances, it would be difficult for a customer considering whether to enter into the mortgage to understand the economic consequences of agreeing to a term that allows Aviva such broad discretion to determine how to apply a VPR. Taking into account the relevant law on unfair terms, the Consumer Rights Act 2015, I think there's a risk that a court would find that a clause this wide and uncertain might not be fair.
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> However, whether or not this is a fair term, my role is to decide if the particular way Aviva chose to apply the VPR in this case is fair and reasonable in all the circumstances – which involves considering not just the term itself, but also whether Aviva acted fairly in making the decision it did. The central issue for me to determine is whether there has been any unfairness to Mr and Mrs C. The fairness of the underlying VPR clause will not, of itself, properly answer that question.
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> Under our rules, we are required to consider what is fair and reasonable in all the circumstances. That includes – but is not limited to – relevant law. So, while I have taken account of the relevant law regarding unfair contractual terms, I've also thought more broadly about whether the way the terms have been used, and the decisions Aviva made, have resulted in Mr and Mrs C being treated unfairly. I think that is the ultimate question I need to answer when weighing up if Mr and Mrs C's case should be upheld.

It isn't in dispute that Mr and Mrs C were allowed, under the terms of the mortgage, to make VPRs. Nor is it in dispute that Aviva didn't set out, in writing, how it would allocate VPRs when Mr and Mrs C took out their lifetime mortgage. The terms and conditions document simply said that 'Aviva will explain to you how any voluntary partial repayment amount will be applied in advance of a voluntary partial repayment being made and will, upon your request, also provide this explanation in writing at that time.'

Aviva has confirmed that it moved to the methodology of applying VPRs to the most recent tranche of borrowing first in November 2019 after consulting on it internally and with its funders in 2018. Aviva refers to this methodology as 'last in, first out' ("LIFO"). Prior to then I understand any VPR made was split across all the tranches of borrowing equally.

Aviva has shared with me part of its impact assessment setting out the rationale which led to its decision to move to the LIFO methodology. That information is commercially confidential. Our rules allow us to receive information in confidence where appropriate, which I think it is in this case.

But, in summary, the information shows Aviva found that a scenario like Mr and Mrs C's - that is, a customer that had both access to draw down further funds and to make a VPR, and that had used both options - was comparatively rare. At the time the document was written it said that of the overall number of mortgages which had access to these facilities, only in less than 1% of cases had customers actually exercised both options. Concerns were raised that there was a risk customers might – intentionally or not – gain advantage by drawing down funds at a lower interest rate and then repaying funds at a higher interest rate.

I'm satisfied that Aviva followed its revised 2019 policy when it allocated Mr and Mrs C's VPRs under the LIFO methodology. But that isn't the end of matters. I also have to decide whether, by reference to the individual circumstances of this complaint, implementing that policy resulted in fair treatment of Mr and Mrs C.

Our Investigator spoke to Mr and Mrs C about why they made the draw downs and the VPRs. Mr and Mrs C said that over the years their income was pretty low, with their money tied up in property and they needed the draw down funds at the time for family reasons, amongst other things. They said that the funds they used to make the VPRs came from the later sale of an investment property, and that was something they always intended to do, knowing they would be paying some of the money back when they were in a position to do so.

I can see from the history of the mortgage that the VPRs were made several months after the last draw down, and were for sums substantially larger than the most recent drawdowns. I'm satisfied that Mr and Mrs C weren't in fact drawing down money with the intention of repaying higher interest rate borrowing with lower interest rate borrowing. Rather, they withdrew funds when they needed them – and then later, and separately, repaid some borrowing when they released funds from a different source. Having realised funds from the sale of a different property, their intention was to get the best use of those funds by repaying the most expensive part of their borrowing.

Mr and Mrs C's request doesn't seem an unreasonable one. They held their borrowing across various sub-accounts, with the interest rates on those being between 2.97% and 4.90% and they wanted to repay the borrowing held on the highest interest rates first.

That has been how some other debts, such as credit cards, have worked for many years. For example, credit card accounts came under scrutiny – including a White Paper and a

Government consultation – which led to issuers changing how payments were allocated in around 2010, moving to an allocation order that meant payments went to higher interest bearing parts of the debt first, to limit consumer detriment.

Whilst this is a different type of borrowing to a credit card account, it is understandable that Mr and Mrs C feel the same methodology should be used for higher value longer term borrowing.

I understand Aviva's concerns that borrowers may, in effect, churn their borrowing, borrowing at a lower interest rate now to repay borrowing they already held at a higher interest rate. I can see that is a potential risk. But I think Aviva's legitimate commercial reasons for wanting to guard against that risk need to be balanced against the impact on Mr and Mrs C of mitigating it in this particular way. From the information Aviva has sent me a very small proportion of customers have the option on their lifetime mortgage to both make draw downs and VPRs, and even less that had actually exercised both options, with Aviva referring to it as "comparatively rare".

By applying its policy to mitigate this risk to Mr and Mrs C, Aviva compelled them to use their VPR to repay the cheaper parts of their borrowing rather than the most expensive – increasing the overall cost of the borrowing over the lifetime term. Given the size of the VPRs and the overall debt, and given that this is a lifetime mortgage, I think insisting on applying the VPRs in this way caused substantial detriment to Mr and Mrs C as compared to applying the VPRs to the most expensive borrowing first. In circumstances where the overall risk of customers manipulating their debt seems to be very low, and given that this is not in fact what Mr and Mrs C were doing, I'm not persuaded that applying the policy to them in these particular circumstances resulted in fair and reasonable treatment.

Mr and Mrs C have said they always intended to make draw downs and then to later make VPRs. They haven't done this to try to 'game the system', instead they have given very clear reasons for the need for the draw downs, and where the funds came from to make the VPRs.

Mr and Mrs C have some clear financial objectives and, as I've explained, I don't think their expectation that they would be able to choose which sub-accounts received the VPRs was unreasonable.

Aviva haven't shown me that it would incur a financial loss if Mr and Mrs C were allowed to repay their higher interest rate sub-accounts first, and I don't think that Aviva treated Mr and Mrs C fairly. I think Aviva should have allowed Mr and Mrs C to choose where their VPRs were allocated, which I understand would have been working through the sub-accounts in order with payments being made to the highest interest rate first, and working down to the lowest interest rate once all the higher interest rate draw downs had been repaid.

I understand, from the information Aviva provided to Mr and Mrs C when the VPRs were made, this would have resulted in the borrowing taken in January 2019 (which I have referred to as sub-account 2) being fully repaid, with the remainder of the funds being used to reduce the balance on the borrowing taken in August 2022 (which I have referred to as sub-account 7). But I'll leave it to Aviva to work this out and confirm what the position would have been had the VPRs been allocated in order of highest interest rate bearing draw downs being repaid first.

I also consider Mr and Mrs C have been caused upset and inconvenience in having the VPRs allocated in a way contrary to their wishes. Having considered this very carefully, and paying due regard to our guidance for such awards and compensation ordered in other cases, I consider Aviva should pay £250 compensation to Mr and Mrs C.’

Mr and Mrs C accepted my provisional findings about which part of the mortgage the VPR’s are allocated to. Aviva expressed its dissatisfaction with my provisional decision but said it would do as I’d asked.

I acknowledge Aviva’s point about the manual work that will be needed and that it is around this time of year that Mr and Mrs C have previously made their VPR. If Mr and Mrs C contact Aviva to make a VPR before the rework is completed then I’m sure Mr and Mrs C will have no issue with that VPR being reworked separately once the initial calculations have been completed.

I’ve considered all the available evidence and arguments to decide what’s fair and reasonable in the circumstances of this complaint.

Having done so, and having considered everything Aviva said in its response to my provisional decision, I see no reason to depart from those provisional findings. Aviva has referred to a previous decision issued by this service on a similar complaint. I’m aware of the complaint Aviva has referred to, but as we decide each case on its individual merits that has no bearing on my decision here.

My final decision

I uphold this complaint and order Aviva Equity Release UK Limited to:

- Rework the account, applying any voluntary partial repayments that Mr and Mrs C have made (up to the date this complaint is settled) to the draw down with the highest interest rate first - and working down from there - backdated to the dates that Mr and Mrs C made the payments. This will mean draw downs that have been repaid, but shouldn’t have been, will need to be reinstated.
- Pay Mr and Mrs C £250 compensation for the distress and inconvenience caused.

I also direct Aviva Equity Release UK Limited to treat any future VPRs made by Mr and Mrs C in the same way, so long as the source of the funds used for the VPR is not a retained draw down.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr and Mrs C to accept or reject my decision before 20 January 2025.

Julia Meadows
Ombudsman